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NEW NORMAL REPORT

INVESTMENT ADVISORY AND FINANCIAL PLANNING FIRM

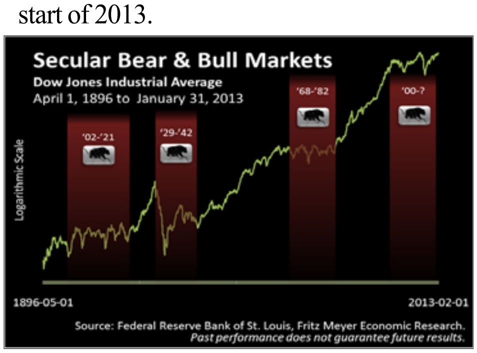
2nd Quarter 2013 www.usaam.com

The Case For A New Secular Bull Market

A secular bull or bear market is a paradox. Despite its long-term status—or perhaps because of it—it's difficult to say when a secular bear wave is ending and a bull wave has begun.

A secular market is different from a cyclical one. A cyclical bear or bull market is when stocks rise or fall 20% or more. You objectively know when you're in a cyclical bear market based on a single number. In contrast, a secular bull or bear market is identified based on more nebulous criteria: optimism and pessimism. How do you measure investor optimism? A key measure is the price-to-earnings (p/e) ratio of stocks.

Secular bull markets are characterized by an expansion of the p/e multiple. People are willing to pay more for stocks because they believe they will appreciate. What's fascinating is that we may right now be at the start of a new secular bull market. A recent rise in the p/e ratio and a confluence of other positive influences makes a case that a new secular bull market began at the start of 2013.



U.S. stocks have endured four secular bear markets, as shown in the accompanying chart. (Periods between bear markets are all bull markets.) After the financial crisis, pessimism about stock investing was so rampant that companies in the Standard & Poor's 500 index, America's blue-chips, were valued at less than 12 times every dollar of profit they earned.

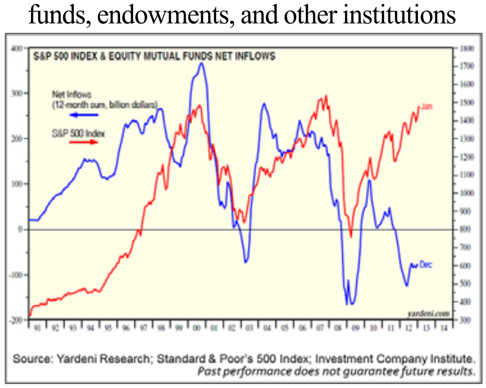
After hitting a low in March 2009, however, the S&P 500 index rose 120% through mid-February 2013. That restored the stock market's p/e ratio to a level in line with the historical norm, but still only at the low end of the historical norm. The market multiple p/e expanded from 12 to 14.6.

In the first quarter of 2013, a confluence of events unfolded that could lead to continued expansion of the market p/e multiple. While there is no certainty this will happen, growing evidence of the shift to a secular bull market should not be ignored. According to a Feb. 9, 2013 article in *Barron's,* we might be on the cusp of a "great rotation into stocks" for several reasons:

Low Yields. The Federal Reserve Bank has kept interest rates low, making stocks relatively more attractive than bonds.

Housing Prices. With housing prices reverting to the historical norm, the "wealth effect" could make homeowners less risk-averse.

Institutional Investors. Pension funds, endowments, and other institutions



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Why Did You Hire Us?

Let's begin by acknowledging two important facts: You are an expert and master of at least one thing – your own life; and we, as advisors, are experts at something else as well – personal finance and investing. When we combine the two, using a collaborative approach designed to help you reach important financial goals for you and your family, we can accomplish great things.

However, our expertise can be utilized only when we work together. Breakdowns in communication or lack of follow-up (and simply falling off the face of the earth) hinder our ability to serve you in the best way possible.

We at USAAM know and understand that life can be hectic, often for an extended period of time. Rather than neglecting your finances when that happens, these are typically the best times to address your financial issues to ensure you remain on track.

Similarly, if there is anything we can do on our part to improve our communication and services, please let us know immediately.

We remain committed to helping you reach your goals through our investment and financial planning services, and are constantly seeking the best ways to deliver on that promise while providing you the best client experience possible.

USA Asset Management

Find Extra Benefits In DI Insurance

The odds that you'll suffer a disabling injury or illness are far greater than the likelihood of you dying prematurely. A disability income (DI) insurance policy, used to supplement life insurance coverage, could help protect you from loss of income if you're unable to work. Indeed, a DI insurance policy might provide even more benefits than you expect.

Typically, a private DI insurance policy can pick up some of the slack if you're disabled for an extended time. Should you no longer be able to work, you will begin receiving a monthly disability benefit. Normally, the benefit is a predetermined amount, unlike employer-provided coverage, in which the benefit equals a percentage of compensation.

As with life insurance, DI terms can vary widely from policy to policy. Some key variables include the amount of the benefits you'll receive; the length of the coverage; the requirements for receiving full benefits; the definition of "disability"; the length of the waiting period before benefits begin; any cost-of-living adjustments; availability of partial benefits; and possible non-cancellation features. Naturally, the cost of the premiums also will vary, depending mainly on those variables.

But don't assume that you must be bedridden to collect any benefits. Frequently, a DI insurance policy will provide "residual benefits" in the event you can work some of the time or if you're slowly getting back on your feet. Some policies even offer benefits after you've returned to work if you are earning less than you did before your disability.

The residual benefits generally kick in when the loss of income is greater than 20% of previous earnings and the decline is due to the medical condition underlying the disability. This feature could be especially valuable to small business owners, including self-employed entrepreneurs, and professionals in fee-based practices, such as physicians, attorneys, and accountants.

For example, suppose a surgeon recovering from a severe illness returned to practice but was able to see fewer patients. If the surgeon's income was reduced from $50,000 a month to $30,000, the residual benefit could restore income to 80% of the pre-disability level—in this case, $40,000 a month. Similarly, if the side effects of chemotherapy make it too hard for a litigator to appear in court or for a CPA to handle a company's books, the residual benefits can soften the economic blow.

To see what your coverage may or may not include, take a close look at existing DI policies or any new policy you're considering and have your insurance agent explain the residual benefits section. The policy might be more valuable than you imagined or the residual benefits may be too restrictive. Those provisions could be a key component of your DI insurance coverage. ●

Straight Talk About Living Trusts

Ask two financial experts about the benefits of using a revocable living trust and you might well get precisely opposite reactions, especially on a regional basis. One might say that it's the greatest thing since sliced bread, while the other could argue that it should be avoided like the plague. The truth probably lies somewhere in between.

How does a living trust work? You set up the trust, transfer assets to it, and name a trustee to handle matters. If you designate yourself as the "initial beneficiary," you're entitled to receive income from the trust for the rest of your life. At the same time, you designate "secondary beneficiaries"—perhaps your spouse, your children, or both spouse and kids—who will receive the remaining assets when the trust terminates.

Additionally, you can still retain some control of assets in a living trust while you're alive. For instance, depending on the trust terms, you may be able to sell assets and keep the proceeds, amend terms of the trust (for example, change secondary beneficiaries), or revoke it entirely. The assets in the trust become irrevocable upon your death.

The main advantage is that assets in a living trust are exempt from probate, a process that may be required for assets bequeathed through a will. Proponents of living trusts note that the probate process can be costly and time-consuming. Also, if you face physical or mental limitations in your old age, with a living trust, a trustee for your assets is already in place.

However, detractors point out there are less expensive ways of avoiding probate, such as acquiring property jointly with rights of survivorship (although this may not be the best option in community property states). Also, the cost and complexity of probate is often exaggerated and can vary greatly from state to state. Finally, despite a common perception to the contrary, there's no estate tax advantage to using a living

10 Reasons For The IRS To Flag Your Return

What sets off alarm bells at the IRS? Due to limited resources, the IRS only audits around 1% of all federal individual tax returns, while the other 99% skate through unexamined. Nevertheless, it pays to keep in mind these 10 “red flags” that could increase the chance you’ll be tapped for an audit.

1. High income. The audit rate for 2011 tax returns, which was about 1.11% overall, jumped to 3.93% for taxpayers with income of $200,000 or more. That’s almost one out of every 25 returns. The IRS tends to chase the “big money,” and while that’s no reason to earn less, you should realize that higher income exposes you to a greater audit risk.

2. Unreported income. The IRS computers match up the income listed on W-2 and 1099 forms with the income reported on individual returns. You’re likely to draw IRS scrutiny if you don’t report all of your taxable income or if you underreport the total, even if an omission is inadvertent. Check your tax forms to ensure the information is accurate.

3. Large charitable gifts. Besides providing personal satisfaction, deductions for charitable gifts can offset highly taxed income on your return. But the IRS may become suspicious if the amount you deduct is disproportionate to your income. In particular, make sure that deductions for gifts of property are legitimate and include an independent appraisal when required.

4. Home office deductions. If you qualify, you can write off your direct costs of using part of your home as an office, plus a percentage of everyday living expenses such as property taxes, mortgage interest, utilities, phone bills, insurance, etc. But the basic rule is that you must use the office “regularly and exclusively” as your principal place of business. Simply doing work at home when your main office is elsewhere won’t cut it.

5. Rental real estate losses. Generally, “passive activity” rules prevent investors from deducting losses on rental real estate. But a special exception allows a loss deduction of up to $25,000 for “active participants,” subject to a phase-out between $100,000 and $150,000 of adjusted gross income (AGI). Another exception applies to qualified real estate professionals. The IRS may zero in on taxpayers claiming losses under either exception.

6. Travel and entertainment expenses. This is often a prime audit target. IRS agents particularly look for self-employed individuals and other business owners who claim unusually large write-offs for travel and entertainment expenses and meals. Note that the tax law includes strict substantiation rules that must be followed in order to deduct any of these expenses.

7. Business use of cars. Another area ripe for abuse by taxpayers is the use of a vehicle for business purposes. The annual amount you can claim via depreciation deductions for the vehicle, based on percentage of business use, is limited by so-called “luxury car” rules. IRS agents have been trained to ferret out taxpayer records that don’t measure up. Another danger signal is a claim for 100% business use of a vehicle, especially if another vehicle isn’t available for personal use.

8. Hobby losses. As a general rule, you can deduct expenses for a hobby only up to the amount of the income it produces. You normally can’t claim a loss for the activity, unless your involvement rises to a level of a bona fide business. Usually, an activity is presumed not to be a hobby if you show a profit in any three out of the past five years, but the IRS can rebut this presumption.

9. Foreign bank accounts. The IRS has started clamping down on taxpayers with offshore accounts in “tax havens” in which banks may not disclose account information. Failure to report foreign income can trigger steep penalties and interest. If you have foreign bank accounts, make sure you properly report the income when you file your return.

10. Cash businesses. Finally, if you operate a small business in which you’re generally paid in cash—for example, if you own a car wash, restaurant or tavern, or a hair or nail salon—the IRS is more likely to examine your return. Past history indicates that cash-heavy taxpayers may underreport their income or, in some cases, not report any income at all. Accordingly, the IRS remains on high alert.

These red flags certainly don’t mean you should shy away from claiming the tax breaks you rightly deserve. Just be prepared to defend your turf if the IRS ever comes calling. ●

trust if you retain the right to revoke it, as is typically provided. And even die-hard supporters of living trusts acknowledge you’ll still need a will to tie up the loose ends of your estate.

So when does a living trust make sense? Consider these four key factors:

1. Age. Younger people in good health have less incentive to use a living trust than do retirees. Remember, a living trust will provide little benefit during your life.

2. Financial status. The more wealth you have, the more you’re likely to benefit from a living trust. It will make things easier on your heirs if some or all of your assets bypass probate.

3. Marital status. If you’re married and you own a house or other main assets jointly with your spouse, there’s less need for a living trust. Furthermore, many states allow surviving spouses to use expedited probate procedures.

4. Confidentiality. One of the main arguments for a living trust is that your testamentary disposition remains confidential. This could be important for some families.

Don’t be swayed by the hype of either point of view. Make an assessment of whether a living trust is right for you. ●

Choosing An Advisor: Big Or Boutique?

A survey from the Luxury Institute shows that high-net-worth investors (with $5 million or more in assets) prefer boutique wealth management firms over Wall Street giants. Those who opt for boutique firms cite quality, exclusivity, and other factors. But what about investors of more limited means? What's the best choice for them—smaller independent firms or big-name companies?

The Wealth Management Luxury Brand Status Index (LBSI) survey from the independent Luxury Institute in New York scores respondents' answers based on each firm's quality, exclusivity, social status, and ability to deliver special client experiences. The average respondent reported $15 million in net worth and income of $720,000.

"Reputations for honesty and superior client service are what make the smaller firms standouts in this survey," says Luxury Institute CEO Milton Pedraza.

Investors have been shifting toward independent advisors for years. The number of independent Registered Investment Advisors, for instance, surged 31% between 2004 and 2010, according to Cerulli Associates Inc. A report by Charles Schwab, the 2012 RIA Benchmarking Study, shows RIAs enjoyed an 8.2% increase in new clients in 2011 (subtracting departing clients cuts the increase to 4.7%), along with a 12% gain in revenue.

The trend is partially due to technology, as smaller firms are now able to offer access to many of the specialized investment vehicles and services that were once the province only of larger corporations with more resources. Declining trust in larger firms in the wake of the 2008 financial crisis is another factor.

Smaller firms enjoy a reputation of being more likely to put clients' needs first, while large firms are believed more likely to push in-house products. Another widespread belief is that smaller firms offer more in-depth, personalized service.

Many investors remain with big-name firms, however, especially if they are primarily looking for investment services that include access to high-end alternative investments. Even though access has become more widespread through technology, many of the larger firms still have an edge in terms of cost.

Some investors have even more specific reasons for sticking with the larger companies. For instance, an executive at a big, publicly traded company who has stock options may want to work directly with the financial services firm that handles that company's options.

Still, many investors have shifted to smaller, independent firms, which tend to offer more comprehensive wealth management services and more coordination among investment, tax, legal, and other advisors.

If you are looking for a financial advisor, consider interviewing advisors from both large and small firms, then compare them in relation to your own needs and goals. ●

New Secular Bull Market

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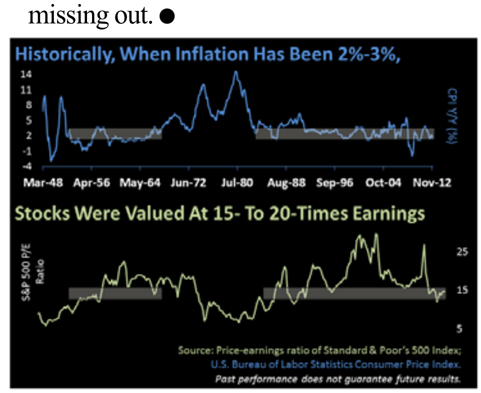
have allocated just 30% of their portfolios to equities since the financial crisis and can't meet their investment goals unless they take more risk by boosting equity allocations.

Retail Investors Return. Since the financial crisis of 2007-2009, retail investors shunned stocks. The accompanying chart shows inflows into stock mutual funds since that time have been anemic recently relative to two previous times when the S&P 500 neared a high point of 1500. According to independent economist Ed Yardeni, the 120% rebound in stock prices that began in March 2009 was fueled by stock buybacks by corporations sitting on cash. Main Street investors were not in on the recent bull run—until December 2012. Then net inflows into stock mutual funds abruptly reversed, according to Investment Company Institute.

If Main Street investors return to stock mutual funds, that would be sign of a major shift in sentiment, a shift toward optimism, which is the mark of a secular bull market. Secular bull markets are characterized by an expanding price multiple on corporate earnings. Optimism makes investors more willing to pay more for earnings. How much can sentiment boost stock prices?

According to economist Fritz Meyer, when the U.S. inflation rate has averaged 2% to 3%, investors have historically valued stocks in the S&P 500 in a range of 15 to 20 times their earnings. In February 2013, when inflation was hovering at about 2%, the S&P 500 was trading at 14.8—the low end of its historical p/e ratio range.

Thus, if a new secular bull market is under way—a scenario bolstered by the great rotation into stocks—gradually increasing optimism could propel expansion of the p/e ratio back into the normal range. Past performance does not indicate your future result, and the case for a new secular bull market could be overly optimistic. But ignoring the favorable data carries a risk of missing out. ●



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